



# United States Department of the Interior



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F OFFICE  
INDIANA

BUREAU OF LAND MANAGEMENT  
LEWISTOWN DISTRICT OFFICE  
AIRPORT ROAD  
P.O. BOX 1160  
LEWISTOWN, MONTANA 59457-1160

IN REPLY TO:

3162.2  
Case File Nos 849 & 5537

JUL 03 1991

CERTIFIED MAIL NUMBER P 376 647 904  
RETURN RECEIPT REQUESTED

Croft Petroleum Company  
ATTN: Mr. Jerry Croft  
214 N. Central Avenue  
P. O. Box 397  
Cut Bank, MT 59427

Re Blackfeet Tribal Lease No. 4313, Lots 9 & 10, in Section 2, and  
Lot 5 in Section 11, T. 37 N., R. 6 W., Glacier County, Montana

## DECISION

Gentlemen

Our letter to you dated July 28, 1988, regarding the Muntzing No. 3 well, located in the SW $\frac{1}{4}$ SW $\frac{1}{4}$  of Section 2, T. 37 N., R. 6 W., Glacier County, which showed the potential for drainage of the Dakota formation underlying the subject lease, stressed the necessity for protecting Tribal Lease No. TL-4313 from drainage. More essentially, Item 3(b) of your lease agreement requires you to protect the said Tribal lease against any offset drainage or compensate the Tribe in full, each month, for the estimated loss of royalty through drainage.

Our Decision Letter to you dated September 20, 1990, called for you to pay compensatory royalty to the Tribe on the basis of the surface ownership in the section containing the Muntzing No. 3 well. On October 4, 1990, Croft Petroleum requested a State Director Review (SDR) of the referenced Decision. On January 9, 1991, the State Director ruled that "Croft Petroleum is not required to amend the existing communitization agreement". Furthermore, the State Director ruled that if it is determined "that a paying protective well could have been drilled, the LDO can re-assess Croft for the amount of compensatory royalties due".

Following the State Director's directives concerning the Decision of September 20, 1990, we determined that a paying protective well could have been drilled on TL-4313 to offset the offending well, Muntzing No. 3. In our Demand Letter dated February 20, 1991, we encouraged Croft Petroleum to submit, within 30 calendar days, a detailed economic analysis showing that a paying well could not have been drilled on the offended Tribal Lease No. TL-4313.

On February 27, 1991, the Law Offices of Anderson, Beatty and Buyske, writing on behalf of Croft Petroleum, offered to negotiate a solution to the case. On March 6, 1991, Nick Douglas of my staff contacted Mr. Jerry Croft to discuss the letter from Croft's legal representatives. The phone conversation did not provide any solution to the problem.

Your correspondence dated March 14, 1991, provided economic analyses along with other valuable data. However, a careful review of the referenced letter reveal some deficiencies. The most serious of the deficiencies are discussed as follows:

- 1) The justification for the drilling of an oil or gas well is based on the limit dictated by the continuity of the reservoir and not on surface acreage limitations of the lease. So, your use of 412 feet as a maximum area of drainage has no basis in calculating reserves attributable to the protective well in question. Your ultimate reserves estimate for the four producing Dakota wells shows that an average Dakota well would be expected to produce 239,967 MCF. In calculating this average, we excluded the production from the best Dakota producer, Tribal No. 2-10 well.
- 2) The economic parameters (gas price, operating cost, etc.) used in your analyses differ from ours but do not change the end result that an economic well could have been drilled.
- 3) We have doubts about the methods you used in calculating your recovery per acre. Recovery factor is a function of the reservoir parameters and gas properties and not a function of surface acreage
- 4) Your concern about recovery of non-Tribal minerals from a Tribal well is not supported by the geologic structural data or the fact that the offsetting non-Tribal lands are protected by a producing Dakota well (Muntzing No. 3). Please note that Tribal minerals are being produced from a non-Tribal well.

In summary, your letter dated March 14, 1991, shows that all the four Dakota wells completed around the Tribal lease were economically productive. Your economic analyses show profit above the cost of drilling, completing and operating the wells. Furthermore, your geologic map shows that the Dakota reservoir continues through the offended Tribal lease. Given your economic analyses for the four Dakota completions, in conjunction with your geology, we believe that a prudent operator could have completed a protective well on the Tribal lease.

On the basis of the above facts, we issued a Decision on March 29, 1991, requiring Croft Petroleum to pay compensatory royalty assessment to the Tribe. Croft Petroleum asked for the State Director's review of this decision. The State Director ruled that the assessment should begin on January 1, 1989, and required us to obtain a written concurrence on the assessment from both the Tribe and the BIA.

Your most recent letter to the Montana State Office dated June 6, 1991, raised issues like production taxes, gas price forecast, tax rate for Croft's economic analysis, and gas production. These concerns are addressed as follows:

1) Estimating Production Taxes:

We are aware that regular state taxes apply on oil and gas wells drilled on Tribal lands. Our phone conversations with Agnes Haggerty indicated that there are no Tribal taxes on gas wells on Indian lands.

Ms. Haggerty further stated that the Tribe is in the process of putting together a tax package for gas wells. Attached is a copy of Tribal Ordinance No. 56 from the Blackfeet Nation, Tax Division. This document highlights the terms that apply to gas production.

2) Tax burden and Economic analysis:

In spite of some uncertainty regarding Tribal tax on gas production, the overall tax burdens used by Croft and the BLM clearly demonstrate that an economic well could have been drilled to protect the Tribal lease.

(a) Tax Correction:

According to Croft Petroleum Company, corrected total tax rate is 17.5% (BLM used 17.90%) while gas price for the offending well, Muntzing No. 3, remains at \$1.26/MCF. Economic analysis based on the corrected tax rate and all other data provided by Croft Petroleum show that a protective well would have yielded a 26.78% return on investment with a discounted payout of 4.75 years (3.36 years, undiscounted). So, Croft's own figures show that an economic well could have been drilled to protect the tribal land from drainage.

3) Price Forecast:

(a) Gas Price Schedule:

Chevron, U.S.A., Inc., is a major international oil and gas operator and is licensed to operate in the State of Montana. Chevron holds Federal leases in T. 37 N., R. 5 E., Flat Coulee Field, Liberty County, Montana. So, price schedule by Chevron is very credible within the petroleum industry. From the onset of this case, Croft Petroleum Company had every opportunity to furnish data to the BLM, but chose not to do so until the case had reached a decision stage.

It should be noted that there were several economic analyses done on this case. Chevron's price schedule was one of the various models used to demonstrate that a prudent operator could have drilled a "paying well" to protect the Tribal land from drainage. Our decision to assess compensatory royalty was influenced by the different economic scenarios. However, the actual assessment is solely based on information/data gathered, at different times, from Croft Petroleum Company during the evaluation of this case.

(b) Crude Oil Prices:

Croft Petroleum Company is referring to decline in oil prices while Chevron's forecast is for gas wells only. As the price of crude oil declined at a rapid rate, the price of natural gas appeared to remain stable or declined at a more gradual rate. Attached is "Natural Gas Wellhead Prices" as published by the Energy Information Administration in 1988. This publication covers the period from 1976-1987 for all gas producing states in the U.S. It should, also, be pointed out that the gas price being received by Croft Petroleum for the offending well has remained stable at \$1.26/MCF.

4) Gross Production/Beginning Rate for Economic Analysis:

Your concern about the first year production used in the economic analysis is clearly explained in the second paragraph of Exhibit E. The beginning rate is based on the average of the first six months production for the Muntzing Nos. 3 & 4 wells, and TL No. 11-3 well. It should be noted that the beginning rate used in the analysis is lower than those of the aforementioned wells.

The response from your attorney, our subsequent telephone discussions with Mr. Jerry Croft, and your economic analyses have failed to provide any remedy for the payment of past compensations or economic justification for not drilling a protective well. As a result, we have determined that compensatory royalty assessment is the only equitable solution with regards to Lease No. 14-20-0251-4313.

Therefore, compensatory royalty is assessed. In conformity with the State Director review decision, this assessment will begin on January 1, 1989, and end the date that protection is provided or the date that the Muntzing No. 3 well ceases to produce. The portion of the draining well's production attributed to the subject lease has been determined to be 31.85%. This percentage is based on the following:

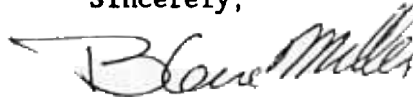
- 1) The ratio of Indian Acreage drained by the Muntzing No 3 to the total area drained by the said well, in Section 2, T. 37 N., R. 6 W.

You will receive a notice of payment for compensatory royalty from the Minerals Management Service. As appropriate, this matter will be referred to the Minerals Management Service for the computation and issuance of a bill for the amount due.

You have the right to request a State Director review for this decision pursuant to 43 CFR 3165.3(b), a copy attached, and if adversely affected by the State Director's decision, to appeal that decision to the Interior Board of Land appeals pursuant to 43 CFR 3165.4(a), 4.411 and 4.413, copy of each attached. Should you fail to request timely a State Director Review, or after receiving the State Director's decision, fail to file an appeal timely, no further administrative review of this decision will be possible.

If you have any questions, please contact Nick Douglas or Jim Mitchell of my staff at 406-538-7461.

Sincerely,

A handwritten signature in dark ink, appearing to read "B. Gene Miller". The signature is fluid and cursive, with the first name "B. Gene" and the last name "Miller" clearly distinguishable.

**B. Gene Miller**

**8 Attachments**

- 1-43 CFR 3165.3(b)
- 2-43 CFR 3165.4(a)
- 3-4.411
- 4-4.413
- 5-Tribal Ordinance No. 56
- 6-Natural Gas Wellhead Prices
- 7-Economic Analysis with corrected Tax rate (17.5%)
- 8-Exhibit E, Basis for Beginning Rate

cc Bureau of Indian Affairs  
Blackfeet Agency  
P.O. Box 850  
Browning, MT 59417  
MSO-Adjudication (922)  
GFRA  
T. Eggart/LDO  
Case File Nos. 849 & 5537